

July 29, 2005

Iris P. Yang
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555 Capitol Mall, 9th Floor
Sacramento, CA 95814-4692

**Re: Your Request for Informal Assistance
Our File No. I-05-113**

Dear Ms. Yang:

This letter is in response to your request on behalf of councilmembers John Miller and Rory Ramirez for advice regarding conflict-of-interest provisions of the Political Reform Act (the “Act”).¹ Because your questions do not involve specific governmental decisions, we can provide you only informal assistance. Informal assistance does not provide the requestor with the immunity provided by an opinion or formal written advice. (Regulation 18329(c), copy enclosed.) In addition, our advice is based on the facts presented in your request; the Commission does not act as a finder of fact when it provides advice. (*In re Oglesby* (1975) 1 FPPC Ops. 71.)

QUESTIONS

1. For purposes of applying the “Public Generally” Exception under regulation 18707.5, should transactions and income received only at Councilmember Miller’s store located within the jurisdiction (Yuba City) be considered?

2. Under regulation 18707.5(c), would Councilmember Miller be required to disqualify himself from participating in a decision affecting a customer if the council member does not “have reason to know” that such a person is a customer of his?

3. May Councilmember Ramirez participate in city council decisions involving a developer who has made a tax-deductible donation to the Fremont Rideout Health Foundation (the “Foundation”) which employs his wife? What if the council member asked the developer to make the contribution to the Foundation and the developer does so?

¹ Government Code sections 81000 – 91014. Commission regulations appear at Title 2, sections 18109-18997, of the California Code of Regulations.

CONCLUSIONS

1. Yes. Only the transactions and income received in the Councilmember Miller's Yuba City store, which is within the official's jurisdiction, should be considered in applying regulation 18707.5.

2. If the requirements under regulation 18707.5(c) are met, Councilmember Miller would not be required to disqualify himself from participating in a decision affecting a customer if the council member does not "have reason to know" that such a person is a customer of his. See discussion below.

3: Councilmember Ramirez may not participate in city council decisions involving a developer who has made a tax-deductible contribution to the Foundation if the contribution will result in a material financial effect on his sources of income or his personal finances and those of his immediate family. If the council member asked the developer to make the contribution to the Foundation and the developer does so, the council member may have limited reporting obligations under section 82015(b)(2)(B)(iii).

FACTS

Councilmember Miller:

Councilmember Miller is a more than 10% owner of a business entity that has five retail stores, the main one of which is located within the city limits of Yuba City. The other four stores are in other jurisdictions. Councilmember Miller is a dealer of John Deere equipment, but he also sells other lawn and garden equipment and products for residential use, as well as children's toys and other miscellaneous items. His store also sells parts for these products and has a service department. There are other stores, such as Home Depot, which sell similar products in Yuba City.

Yuba City has a population of approximately 58,000 persons. If one considers the average household to have 3 persons, there would be approximately 19,333 households within Yuba City; 10 percent of that number would be 1,933 households.

Councilmember Miller has approximately 1,000 customers who have charge accounts at the Yuba City store. Many of these customers will conduct multiple transactions within the year. However, he estimates that he has well over 1,000 additional customers a year at the Yuba City store. He bases this estimate on the fact that in the last year, the Yuba City store had more than 18,000 retail transactions, more than 14,700 of which were for equipment and parts; the other 3,300 were for service orders. The annual gross revenues at the Yuba City store are approximately \$10 million. It is also possible that some Yuba City customers may make purchases at more than one of his stores, two of which are located in Woodland and Robbins, and within a short drive of Yuba City.

Councilmember Ramirez

Councilmember Ramirez' wife is the Director of Community Relations for the Fremont Rideout Healthgroup Foundation (the "Foundation"), which is a non-profit corporation, and serves primarily as a fundraising arm for the Fremont Rideout Healthgroup (the "Healthgroup"), although it also conducts training and other educational programs. The Foundation and the Healthgroup are separate legal entities. In a phone call on July 11, 2005, you stated that the Foundation and Healthgroup have separate boards, but are affiliated entities. However, you did not know if the two entities have shared employees or management.

Councilmember Ramirez' wife is paid a base salary which is established by the Healthgroup, rather than the Foundation. In addition, like most of the other employees at the management level, she is eligible to receive additional compensation under an incentive program. Each eligible employee, along with the Healthgroup's compensation committee, annually sets certain goals for himself or herself. At the end of the year, the Healthgroup's compensation committee determines the amount of the bonus, based on the committee's assessment of whether the employee has achieved the stated goals. Among the various goals for Councilmember Ramirez' wife may be her ability to increase contributions to the Foundation. This goal applies to other management-level employees as well.

The Foundation sponsors certain fundraising events throughout the community every year, such as a golf tournament. All donations to the Foundation are tax deductible. There are many local donors to the Foundation and/or its events; several local developers make donations to the Foundation and some sit on the Foundation board.

In a telephone call on July 11, 2005, you provided additional information regarding developers who have made donations to the Foundation. The developers are: KB Homes, which donated \$1,000; AG Montna which donated \$1,000; and Reynan and Bardis, which donated \$3,500, at Councilmember Ramirez's request.

You further stated that the council member believes that these contributions do not have an effect on his spouse's salary, because there are more than 2,000 individual donors to the Foundation, and increasing donations to the Foundation is but one of a number of criteria considered by the Healthgroup's compensation committee in determining the amount of bonus a management-level Foundation employee receives.

ANALYSIS

The Act's conflict of interest provisions ensure that public officials "perform their duties in an impartial manner, free from bias caused by their own financial interests or the financial interests of persons who have supported them." (Section 81001(b).) Specifically, section 87100 prohibits any public official from making, participating in

making, or otherwise using his or her official position to influence a governmental decision in which the official has a financial interest.

A public official has a “financial interest” in a governmental decision within the meaning of the Act, if it is reasonably foreseeable that the governmental decision will have a material financial effect on one or more of the public official’s economic interests. (Section 87103; regulation 18700(a).) The Commission has adopted a standard analysis for deciding whether an individual has a disqualifying conflict of interest in a given governmental decision. (Regulation 18700(b)(1)-(8).)

Councilmember Miller

Due to the specificity of your request regarding Councilmember Miller, which concerns the applicability of a special exemption to the conflict-of-interest rules, we will focus only on Step 7, the “Public Generally Exception,” in response to Question 1.²

Under the public generally exception, even if a public official otherwise has a conflict of interest, he or she may still be able to take a role in the governmental decision in question. If the reasonably foreseeable material financial effect of a governmental decision on the public official’s economic interest is indistinguishable “from its effect on the public generally,” then the public official does not have a conflict. (Section 87103; regulations 18700(b)(7), 18707(a).)

There are seven forms of the “public generally” exception: a general exception (regulation 18707.1) and six specialized forms of the exception (regulations 18707.2 - 18707.9). You ask only about regulation 18707. 5 “Sources of Income to Owners of Retail Business Entities.”

Regulation 18707.5 is one such specialized form of the “public generally” exception. It generally states that retail customers of a business entity engaged in retail sales of goods and services to the public will not be considered sources of income to a public official owning 10% or more of a business entity, if the retail customers as a whole comprise a *significant segment* of the public generally, *and* the amount of income received by the business entity from the customer is *indistinguishable from the effect upon the entity’s retail customers as a whole*. (Section 87103.5; regulation 18707.5)

Regulation 18707.5 sets out a two-pronged test. *Both prongs must be satisfied* if the exception is to apply. First, “the retail customers of the business entity during the preceding 12 months” must be either “sufficient in number to equal 10 percent or more of the *population or households of the jurisdiction*” or “number at least ten thousand.” (Regulation 18707.5(a)(1), (2).)

² Your facts indicate that the first six steps have been clearly met, as outlined in our earlier advice letter to your firm, *Hayes Advice Letter*, No. I-05-035.

If this numerical threshold is met, then subsection (b) of regulation 18707.5 provides that the amount of income received from a particular customer is not distinguishable from the amount received from other customers if the amount spent by that customer during the preceding 12 months is less than one-tenth of 1 percent of the gross sales revenues of the business for the preceding fiscal year.

Question 1:

Significant Segment Test: Regulation 18707.5 (a)(1) states, “For purposes of Government Code section 87103.5(a), as to *a business entity* located *in a jurisdiction* with a population of more than 10,000 or which is located in a county with more than 350 retail businesses, the retail customers constitute a significant segment of the public generally if either of the following applies:

“(A) The *retail customers* of the business entity during the preceding 12 months are *sufficient in number to equal 10 percent or more* of the population or households *of the jurisdiction*; or

“(B) The *retail customers of the business entity* during the preceding 12 months number at least 10,000.

“(2) For purposes of Government Code section 87103.5(b), as to *a business entity* located *in a jurisdiction* with a population of 10,000 or less which is located in a county with 350 or fewer retail businesses, the retail customers constitute a significant segment of the public generally if the retail customers of the business entity during the preceding 12 months are sufficient in number to equal 10 percent or more of the population or households of the jurisdiction.”

The regulation refers to a numerical threshold of “*retail customers*” of the business entity of “*a jurisdiction*” and of a “*business entity*” located “*in a jurisdiction*.” The language of the regulation appears to restrict the calculation involving the number of retail customers of a business entity, and the income received from a particular customer, to a single jurisdiction or district.

Indistinguishable Income Test: Regulation 18707.5(b)(1) states “For purposes of Government Code section 87103.5(a), as to *a business entity* located *in a jurisdiction* with a population of more than 10,000 or which is located in a county with more than 350 retail businesses, the amount of income received from a retail customer is not distinguishable from the amount of income received from its other retail customers if the amount spent by the customer in question is less than one-tenth of one percent of the gross sales revenues that the business entity earned during the 12 months prior to the time the decision is made.

Although a different interpretation could be possible, the plain language of the regulation suggests that the transactions and customers to be counted are limited to a *specific jurisdiction*. Furthermore, a review of the regulation history indicates that the jurisdictional limitation is what the Commission intended when it originally adopted the regulation.³

In previous advice, we have construed the requirements of this regulation to apply only to retail customers and sales in the official's jurisdiction or district. In the *Hayes* Advice Letter, No. I-05-035, we advised your firm that, "For the purposes of regulation 18707.5, only retail customers and revenues to a business entity that come from the official's jurisdiction count."

Therefore, only the transactions and income received in the Councilmember Miller's Yuba City store, which is in the official's jurisdiction, should be considered in applying regulation 18707.5. For instance, this would not include customers who also make purchases at the Woodland store, or the Councilmember's other stores (outside Yuba City).

Question 2:

Assuming that an official will have a conflict of interest arising from a customer, as indicated in Question 2, the exception will apply *only if a significant segment*, as defined in regulation 18707.5(a)(1)(A), *of the jurisdiction or district is affected in substantially the same manner*, as defined in regulation 18707.5(b)(1), as the manner in which the customer is affected.

You had asked about whether Councilmember Miller may participate in a decision affecting a person he does not "have reason to know" is a customer or a source of income to him, if the official otherwise meets the requirements under regulation 18707.5(c)(1)-(2).

Generally, the regulation would be applied as follows: an official would not "have reason to know" if *all* of the requirements are met under regulation 18707.5(c)(1) or 18707.5(c)(2). For instance, under regulation 18707.5(c)(1), an official would not "have reason to know" that a person is a customer if *all the following are true*:

³ A July 31, 1988 memorandum to Commissioners from Commission Counsel Robert E. Leidigh stated, "The regulation establishes criteria for determining whether the customers of a retail business are sufficient to be a significant segment of the public *in the official's jurisdiction*," referring to regulation 18707.5(a). See also memorandum to Commissioners by Commission Counsel Jill Stecher dated December 1, 2003 which states that regulation 18707.5(b), which sets the standards used to determine whether income received from a retail customer is distinguishable from income received from other retail customers, is "similar to (regulation 18707.5) subdivision (a)(1)" with "*identical clarifying language* (that) has been added to (b)(1) that applies to a *large jurisdiction* 'with a population of more than 10,000 or which is located in a county with more than 350 retail businesses.'"

“(A) The customer does not have a charge account or open book account with the retail business; and

“(B) The retail business does not maintain records for noncharge customer transactions by customer name or other method for tracking transactions which would provide the customer name; and

“(C) The fact that the person is a customer not personally known to the official;”

Likewise, the official does not “have reason to know” is a customer or a source of income to him, if the official meets the requirements under regulation 18707.5(c)(2). The regulation states that the official would not “have reason to know” that a person is a customer if: (1) the store’s books are maintained by someone other than the official or a member of his or her immediate family *and* (2) the official does not personally know that the person is a customer.

Also under regulation 18707.5(e), even if the above requirements are met, the official may still have to disqualify himself or herself from participating in a decision affecting a customer if the official is somehow made aware of the fact that a person is a customer.

Question 3: Councilmember Ramirez

Assuming that Councilmember Ramirez will make or participate in making a decision involving a developer who makes a tax-deductible contribution to a foundation, which is a source of income to his spouse, a Step 3 analysis will be necessary to determine if a potential conflict of interest would result.

Step 3: What are the Councilmember’s economic interests — the possible sources of a conflict of interest?

Section 87103 provides that a public official has a “financial interest” in a governmental decision if it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from its effect on the public generally, on the official, a member of his or her immediate family, or on any of the official’s economic interests, described as follows:

- An economic interest in a business entity in which he or she has a direct or indirect investment of \$2,000 or more (Section 87103(a); regulation 18703.1(a)); or in which he or she is a director, officer, partner, trustee, employee, or holds any position of management (Section 87103(d); regulation 18703.1(b));
- An economic interest in real property in which he or she has a direct or indirect interest of \$2,000 or more (Section 87103(b); regulation 18703.2);

- An economic interest in any source of income, including promised income, which aggregates to \$500 or more within 12 months prior to the decision (Section 87103(c); regulation 18703.3);
- An economic interest in any source of gifts to him or her if the gifts aggregate to \$360 or more within 12 months prior to the decision (Section 87103(e); regulation 18703.4);

In addition, a public official always has an economic interest in his or her personal finances, including those of his or her immediate family -- this is the “personal financial effects” rule (Section 87103; regulation 18703.5).

Economic interests disclosed in your request for informal assistance

Sources of Income/Community Property Interest

Foundation: A public official has an economic interest in any person, including an entity designated as a non-profit entity under section 501(c)(3) of the Internal Revenue Code, from whom he or she has received income which aggregates to \$500 or more within 12 months prior to the governmental decision. (Section 87103(c); regulation 18703.3(a)(1)).

Under the Act, the income of a public official includes any community property interest in the income of a spouse. The Act defines “income” in section 82030, in pertinent part, as follows:

“(a) ‘Income’ means, except as provided in subdivision (b), a payment received, including but not limited to any salary, wage, advance, dividend, interest, rent, proceeds from any sale, gift, including any gift of food or beverage, loan, forgiveness or payment of indebtedness received by the filer, reimbursement for expenses, per diem, or contribution to an insurance or pension program paid by any person other than an employer, and including any community property interest in the income of a spouse.”

Your letter states that Councilmember Ramirez’s wife is employed by the Foundation. Thus, the Foundation is a source of income to the councilmember through his community property interest in his wife’s salary and benefits. (Section 82030.) Councilmember Ramirez will therefore have an economic interest in the Foundation if his community property share of the spouse’s income is at least \$500. This will occur when the council member’s spouse has earned or received at least \$ 1,000 from the Foundation during the previous twelve months.

Healthgroup: For conflict of interest purposes, the Commission has “pierced” through entities, such as for-profit and non-profit corporations, on some occasions based on the nature of the relationship between the entity and those who control the entity.

Under these circumstances, multiple persons/entities may be treated as sources of income. (*Atigh* Advice Letter, No. I-93-383, *Hogin* Advice Letter, No. A-05-070.)

In addition, in certain circumstances when the relationship between the public official and his or her employer is controlled by *persons* (including non-profit entities), who also effectively control decisions of the employer, we have advised that these individuals are considered to be sources of income and economic interests to the official. (*Deadrick* Advice Letter, I-03-143; *Hentschke* Advice Letter, No. A-80-069.)

You state in your letter that Councilmember Ramirez's wife is paid a base salary which is established by the Healthgroup, rather than the Foundation – the spouse's non-profit employer which serves primarily as the fundraising arm for the Healthgroup. You also state that Councilmember Ramirez's wife is "eligible to receive additional compensation under an incentive program." The Healthgroup's compensation committee determines the amount of the bonus based on certain goals set by the committee and the employee. Among the goals for Councilmember Ramirez' wife is her ability to raise contributions to the Foundation.

In a phone call on July 11, 2005, you said that the two organizations were separate legal entities that were "affiliated." You did not know if the Foundation is controlled by the Healthgroup, or if the two non-profits shared employees or management. However, two entities appear to share some resources since they have the same address.

Based on your facts, it appears that the relationship between Councilmember Ramirez's wife and her employer, the Foundation, is substantially controlled by the Healthgroup, as it sets the amount of salary paid to her, as well as any additional compensation under the incentive program. Thus, consistent with the rationale set forth in previous advice letters cited above, we would also consider the Healthgroup as a source of income to the council member's wife, and both would be economic interests of hers. Further, the Healthgroup is also a source of income to the councilmember through his community property interest in his wife's salary and benefits, if his share of his spouse's income is at least \$500. (Sections 82030 and Section 87103(c); regulation 18703.3(a)(1).).

Developers: KB Homes, AG Montna, Reynan and Bardis: Section 82028 defines a gift to be "any payment that confers a personal benefit on the recipient, to the extent that consideration of equal or greater value is not received." Section 82030(a) defines "income" as "a payment received, including but not limited to, any salary, wage or advance..." While donors to the nonprofit do not pay income to the council member's spouse directly, under certain circumstances, the Commission has pierced through a non-profit employer to determine if the donors are sources of gifts or income to the official. In the *Shaw* Advice Letter, No. A-87-045, we advised that piercing was appropriate where donations to a non-profit constituted a significant portion of salary of the president of the non-profit. In *Shaw* a developer considered making a donation to a non-profit formed by the spouse of a planning commissioner. The spouse, who was acting as

president and chief of the non-profit, was not receiving a salary for his work at the time. The letter stated:

“You have also asked whether the Institute’s ongoing donation drive could present possible conflict situations. As an example you have asked whether [the planning commissioner] would be disqualified in a situation in which a restaurateur makes an endowment to the Institute and the restaurateur later applies to the planning commission for a building addition permit. The answer to this question could depend on whether [the planning commissioner’s spouse] was receiving income from the Institute, whether the endowment would affect that income, the size of the endowment, etc. For example, if the endowment paid all or a portion of the [planning commissioner’s spouse’s] income it could be a basis for disqualification.”

You stated in a telephone call on July 11, 2005, that the following developers made tax-deductible donations to the Foundation: KB Homes, which donated \$1,000; AG Montna which donated \$1,000; and Reynan and Bardis, which contributed \$3,500, at Councilmember Ramirez’s request.⁴ Under your facts, however, these donations did not pay all or a portion of the official’s spouse’s salary. Thus, the developers are not considered sources of income as contemplated in *Shaw*.”

However, the developers may be considered a source of income by virtue of the incentive compensation the council member’s spouse receives. Regulation 18703.3(a)(1) defines source of income to include any person from whom the public official receives commission income and incentive compensation. Regulation 18703.3(d), which codified the Commission’s opinion in *In re Hanko*, (2002) 16 FPPC Ops. 1, states that incentive compensation “means income received by an official who is an employee, over and above salary, which is either ongoing or cumulative, or both, as sales or purchases of goods or services accumulate.”

Regulation 18703.3(d) further states that: “Incentive compensation is calculated by a predetermined formula set by the official’s employer which correlates to the conduct of the purchaser in *direct responses* to the effort of the official. Incentive compensation does not include: salary; commission income; bonuses for activity not related to sales or marketing, the amount of which is based solely on merit or hours worked over and above a predetermined minimum; and such executive incentive plans as may be based on

⁴ You had also asked about contributions made at the request of the council member. If the councilmember asked the developer to make the contribution to the Foundation and the developer does so, the councilmember may have limited reporting obligations under (Section 82015(b)(2)(B)(iii), copy enclosed. See also *Sundberg* Advice Letter, A-05-087, also enclosed.). Thus, even though payments by the developers to the Foundation are not reportable contributions or gifts there is limited reporting of these payments, if “within 30 days following the date on which the payment or payments equal or exceed five thousand dollars (\$ 5,000) in the aggregate from the same source in the same calendar year in which they are made.” (Section 82015(b)(2)(B)(iii).)

company performance, provided that the formula for determining the amount of the executive's incentive income does not include a correlation between that amount and increased profits derived from increased business with specific and identifiable clients or customers of the company... (emphasis added)"

Thus, it appears from the facts you have given that the bonuses Councilmember Ramirez's wife receives are not incentive compensation because they do not appear to be linked to "sales of goods or services" and they are "bonuses for activity not related to sales or marketing." Accordingly, the developers who contribute to the Foundation are not sources of incentive income to Councilmember Ramirez's wife.

Personal Finances:

Lastly, Councilmember Ramirez also has an economic interest in his personal finances and those of his immediate family. (Section 87103; Regulation 18703.5.) A governmental decision will have an effect on this economic interest if the decision will result in the personal expenses, income, assets or liabilities of the official or his or her immediate family increasing or decreasing. (Ibid.)

You did not mention any impact on the council member's personal finances and those of his immediate family as the result of a specific governmental decision, therefore we do not further analyze this issue. But note that a conflict of interest may arise if it reasonably foreseeable that a decision will have an effect on the council member's personal finances and those of his immediate family.

If you have any other questions regarding this matter, please contact me at (916) 322-5660.

Sincerely,

Luisa Menchaca
General Counsel

By: Emelyn Rodriguez
Counsel, Legal Division

Enclosures
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